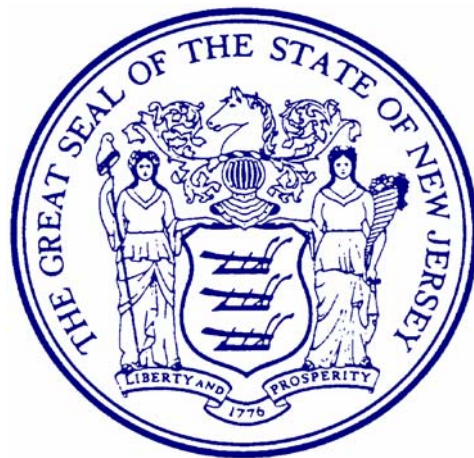


**ACE GAMING, LLC T/A SANDS CASINO & HOTEL  
QUARTERLY REPORT**

**FOR THE QUARTER ENDED SEPTEMBER 30, 2006**

**SUBMITTED TO THE  
CASINO CONTROL COMMISSION  
OF THE  
STATE OF NEW JERSEY**



**DIVISION OF FINANCIAL EVALUATION  
REPORTING MANUAL**

# ACE GAMING, LLC T/A SANDS CASINO & HOTEL

## BALANCE SHEETS

AS OF SEPTEMBER 30, 2006 AND 2005

(UNAUDITED)  
(\$ IN THOUSANDS)

Line (a)	Description (b)	Notes	2006 (c)	2005 (d)	
	<u>ASSETS:</u>				
	Current Assets:				
1	Cash and Cash Equivalents.....		\$19,043	\$14,209	
2	Short-Term Investments.....				
3	Receivables and Patrons' Checks (Net of Allowance for Doubtful Accounts - 2006, \$3,435; 2005, \$3,745).....		3,839	4,549	*
4	Inventories .....		2,400	2,493	
5	Other Current Assets.....	Note 8	4,788	6,149	*
6	Total Current Assets.....		30,070	27,400	*
7	Investments, Advances, and Receivables.....	Note 9	13,530	12,696	
8	Property and Equipment - Gross.....	Note 10	226,353	221,235	
9	Less: Accumulated Depreciation and Amortization.....	Note 6,10	(71,987)	(58,132)	
10	Property and Equipment - Net.....	Note 10	154,366	163,103	
11	Other Assets.....		980	1,633	
12	Total Assets.....		\$198,946	\$204,832	*
	<u>LIABILITIES AND EQUITY:</u>				
	Current Liabilities:				
13	Accounts Payable.....		\$3,923	\$5,670	*
14	Notes Payable.....		0	1,000	*
	Current Portion of Long-Term Debt:				
15	Due to Affiliates.....				
16	External.....		280	305	
17	Income Taxes Payable and Accrued.....		39	24	*
18	Other Accrued Expenses.....	Note 11	20,774	11,113	*
19	Other Current Liabilities.....	Note 12	3,984	4,087	*
20	Total Current Liabilities.....		29,000	22,199	
	Long-Term Debt:				
21	Due to Affiliates.....				
22	External.....		35	330	
23	Deferred Credits .....				
24	Other Liabilities.....	Note 13	4,434	4,270	
25	Commitments and Contingencies.....				
26	Total Liabilities.....		33,469	26,799	*
27	Stockholders', Partners', or Proprietor's Equity.....		165,477	178,033	*
28	Total Liabilities and Equity.....		\$198,946	\$204,832	*

\* Restated to confirm with current year presentation.

The accompanying notes are an integral part of the financial statements.

Valid comparisons cannot be made without using information contained in the notes.

# ACE GAMING, LLC T/A SANDS CASINO & HOTEL

## STATEMENTS OF INCOME

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005

(UNAUDITED)  
(\$ IN THOUSANDS)

Line (a)	Description (b)	Notes	2006 (c)	2005 (d)
	Revenue:			
1	Casino.....		\$130,700	\$136,568
2	Rooms.....		10,121	8,889
3	Food and Beverage.....		14,651	17,506
4	Other.....		1,685	2,616
5	Total Revenue.....		157,157	165,579
6	Less: Promotional Allowances.....		33,163	40,233
7	Net Revenue.....		123,994	125,346
	Costs and Expenses:			
8	Cost of Goods and Services.....		81,455	86,956 *
9	Selling, General, and Administrative.....		38,499	28,208 *
10	Provision for Doubtful Accounts.....		441	278
11	Total Costs and Expenses.....		120,395	115,442 *
12	Gross Operating Profit.....		3,599	9,904 *
13	Depreciation and Amortization.....		10,178	12,092 *
	Charges from Affiliates Other than Interest:			
14	Management Fees.....		323	477 *
15	Other.....			
16	Income (Loss) from Operations.....		(6,902)	(2,665) *
	Other Income (Expenses):			
17	Interest Expense - Affiliates.....			
18	Interest Expense - External.....		(298)	(472) *
19	CRDA Related Income (Expense) - Net.....		(870)	(508)
20	Nonoperating Income (Expense) - Net.....	Note 14	776	400
21	Total Other Income (Expenses).....		(392)	(580) *
22	Income (Loss) Before Taxes and Extraordinary Items.....		(7,294)	(3,245) *
23	Provision (Credit) for Income Taxes.....	Note 7	175	764
24	Income (Loss) Before Extraordinary Items.....		(7,469)	(4,009) *
	Extraordinary Items (Net of Income Taxes -			
25	2006, \$0; 2005, \$0 ).....			
26	Net Income (Loss).....		(\$7,469)	(\$4,009) *

\* Restated to conform with current year presentation.

The accompanying notes are an integral part of the financial statements.  
Valid comparisons cannot be made without using information contained in the notes.

# ACE GAMING, LLC T/A SANDS CASINO & HOTEL

## STATEMENTS OF INCOME

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005

(UNAUDITED)  
(\$ IN THOUSANDS)

Line (a)	Description (b)	Notes	2006 (c)	2005 (d)
	Revenue:			
1	Casino.....		\$44,002	\$48,349
2	Rooms.....		3,836	3,705
3	Food and Beverage.....		5,500	7,225
4	Other.....		547	923
5	Total Revenue.....		53,885	60,202
6	Less: Promotional Allowances.....		12,320	15,744
7	Net Revenue.....		41,565	44,458
	Costs and Expenses:			
8	Cost of Goods and Services.....		27,331	31,007 *
9	Selling, General, and Administrative.....		19,860	10,150 *
10	Provision for Doubtful Accounts.....		230	121
11	Total Costs and Expenses.....		47,421	41,278 *
12	Gross Operating Profit.....		(5,856)	3,180 *
13	Depreciation and Amortization.....		2,539	4,080 *
	Charges from Affiliates Other than Interest:			
14	Management Fees.....		109	86 *
15	Other.....			
16	Income (Loss) from Operations.....		(8,504)	(986) *
	Other Income (Expenses):			
17	Interest Expense - Affiliates.....			
18	Interest Expense - External.....		(82)	(150) *
19	CRDA Related Income (Expense) - Net.....		(237)	(294) *
20	Nonoperating Income (Expense) - Net.....		307	167 *
21	Total Other Income (Expenses).....		(12)	(277) *
22	Income (Loss) Before Taxes and Extraordinary Items.....		(8,516)	(1,263) *
23	Provision (Credit) for Income Taxes.....		(331)	265
24	Income (Loss) Before Extraordinary Items.....		(8,185)	(1,528) *
	Extraordinary Items (Net of Income Taxes -			
25	2006, \$____; 2005, \$____ ).....			
26	Net Income (Loss).....		(\$8,185)	(\$1,528) *

\* Restated to conform with current year presentation.

The accompanying notes are an integral part of the financial statements.  
Valid comparisons cannot be made without using information contained in the notes.

# ACE GAMING, LLC T/A SANDS CASINO & HOTEL

## STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

FOR THE TWELVE MONTHS ENDED DECEMBER 31, 2005 AND THE NINE MONTHS ENDED SEPTEMBER 30, 2006

(UNAUDITED)  
(\$ IN THOUSANDS)

Line (a)	Description (b)	Notes	Common Stock		Preferred Stock		Additional Paid-In Capital (g)		Retained Earnings (Accumulated Deficit) (i)	Total Stockholders' Equity (Deficit) (j)
			Shares (c)	Amount (d)	Shares (e)	Amount (f)				
1	Balance, December 31, 2004.....						\$228,934		(\$44,294)	\$184,640
2	Net Income (Loss) - 2005.....								(6,782)	(6,782)
3	Contribution to Paid-in-Capital.....									0
4	Dividends.....									0
5	Prior Period Adjustments.....									0
6	Capital Withdrawals						(2,598)			(2,598)
7										0
8										0
9										0
10	Balance, December 31, 2005.....		0	0	0	0	226,336	0	(51,076)	175,260
11	Net Income (Loss) - 2006.....								(7,469)	(7,469)
12	Contribution to Paid-in-Capital.....									0
13	Dividends.....									0
14	Prior Period Adjustments.....									0
15	Capital Withdrawals						(2,314)			(2,314)
16										0
17										0
18										0
19	Balance, September 30, 2006 .....		0	\$0	0	\$0	\$224,022	\$0	(\$58,545)	\$165,477

The accompanying notes are an integral part of the financial statements.  
Valid comparisons cannot be made without using information contained in the notes.

# ACE GAMING, LLC T/A SANDS CASINO & HOTEL

## STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005

(UNAUDITED)

(\$ IN THOUSANDS)

Line (a)	Description (b)	Notes	2006 (c)	2005 (d)
1	CASH PROVIDED (USED) BY OPERATING ACTIVITIES..		\$16,593	\$7,917 *
	CASH FLOWS FROM INVESTING ACTIVITIES:			
2	Purchase of Short-Term Investments .....			
3	Proceeds from the Sale of Short-Term Investments .....		168	138
4	Cash Outflows for Property and Equipment.....		(3,952)	(3,189)
5	Proceeds from Disposition of Property and Equipment.....		51	6
6	CRDA Obligations .....		(1,590)	(1,693) *
7	Other Investments, Loans and Advances made.....			
8	Proceeds from Other Investments, Loans, and Advances .....			
9	Cash Outflows to Acquire Business Entities.....		0	0
10				
11				
12	Net Cash Provided (Used) By Investing Activities.....		(5,323)	(4,738) *
	CASH FLOWS FROM FINANCING ACTIVITIES:			
13	Proceeds from Short-Term Debt .....		1,000	5,186 *
14	Payments to Settle Short-Term Debt.....		(4,548)	(4,186) *
15	Proceeds from Long-Term Debt .....		(30)	47
16	Costs of Issuing Debt.....			
17	Payments to Settle Long-Term Debt.....		(216)	(174)
18	Cash Proceeds from Issuing Stock or Capital Contributions...		0	0
19	Purchases of Treasury Stock.....			
20	Payments of Dividends or Capital Withdrawals.....		(2,143)	(2,598)
21				
22				
23	Net Cash Provided (Used) By Financing Activities.....		(5,937)	(1,725) *
24	Net Increase (Decrease) in Cash and Cash Equivalents.....		5,333	1,454
25	Cash and Cash Equivalents at Beginning of Period.....		13,710	12,755
26	Cash and Cash Equivalents at End of Period.....		\$19,043	\$14,209
	CASH PAID DURING PERIOD FOR:			
27	Interest (Net of Amount Capitalized).....		\$75	\$300 *
28	Income Taxes.....		\$175	\$764

\* Restated to conform with current year presentation.

The accompanying notes are an integral part of the financial statements.  
Valid comparisons cannot be made without using information contained in the notes.

# ACE GAMING, LLC T/A SANDS CASINO & HOTEL

## STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005

(UNAUDITED)

(\$ IN THOUSANDS)

Line (a)	Description (b)	Notes	2006 (c)	2005 (d)
	<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
29	Net Income (Loss).....		(\$7,469)	(\$4,009) *
30	Depreciation and Amortization of Property and Equipment...		10,004	11,726
31	Amortization of Other Assets.....		174	365 *
32	Amortization of Debt Discount or Premium.....			
33	Deferred Income Taxes - Current .....			
34	Deferred Income Taxes - Noncurrent .....			
35	(Gain) Loss on Disposition of Property and Equipment.....		(37)	(6)
36	(Gain) Loss on CRDA-Related Obligations.....		870	508
37	(Gain) Loss from Other Investment Activities.....			
38	(Increase) Decrease in Receivables and Patrons' Checks .....		702	926 *
39	(Increase) Decrease in Inventories .....		188	6
40	(Increase) Decrease in Other Current Assets.....		2,612	(1,005) *
41	(Increase) Decrease in Other Assets.....		(170)	(399) *
42	Increase (Decrease) in Accounts Payable.....		(1,600)	(1,411) *
43	Increase (Decrease) in Other Current Liabilities .....		11,247	998
44	Increase (Decrease) in Other Liabilities .....		72	218
45				
46				
47	Net Cash Provided (Used) By Operating Activities.....		\$16,593	\$7,917

### SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

	<b>ACQUISITION OF PROPERTY AND EQUIPMENT:</b>			
48	Additions to Property and Equipment.....		(\$3,952)	(\$3,189)
49	Less: Capital Lease Obligations Incurred.....			
50	Cash Outflows for Property and Equipment.....		(\$3,952)	(\$3,189)
	<b>ACQUISITION OF BUSINESS ENTITIES:</b>			
51	Property and Equipment Acquired.....			
52	Goodwill Acquired.....			
53	Other Assets Acquired - net .....			
54	Long-Term Debt Assumed.....			
55	Issuance of Stock or Capital Invested.....			
56	Cash Outflows to Acquire Business Entities.....		\$0	\$0
	<b>STOCK ISSUED OR CAPITAL CONTRIBUTIONS:</b>			
57	Total Issuances of Stock or Capital Contributions.....		\$0	\$0
58	Less: Issuances to Settle Long-Term Debt.....			
59	Consideration in Acquisition of Business Entities.....			
60	Cash Proceeds from Issuing Stock or Capital Contributions.....		\$0	\$0

\* Restated to conform with current year presentation

The accompanying notes are an integral part of the financial statements.

Valid comparisons cannot be made without using information contained in the notes.

# ACE GAMING, LLC T/A SANDS CASINO & HOTEL

## SCHEDULE OF PROMOTIONAL EXPENSES AND ALLOWANCES

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006

(UNAUDITED)  
(\$ IN THOUSANDS)

Line (a)	Description (b)	Promotional Allowances		Promotional Expenses	
		Number of Recipients (c)	Dollar Amount (d)	Number of Recipients (e)	Dollar Amount (f)
1	Rooms	187,038	\$5,190		
2	Food	369,326	5,465		
3	Beverage	1,591,544	4,045		
4	Travel			1,198	634
5	Bus Program Cash	317,678	6,699		
6	Other Cash Complimentaries	183,016	11,702		
7	Entertainment	1,493	53		
8	Retail & Non-Cash Gifts			571,704	3,850
9	Parking			328,295	985
10	Other	1,085	9		
11	Total	2,651,180	\$33,163	901,197	\$5,469

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FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2006

Line (a)	Description (b)	Promotional Allowances		Promotional Expenses	
		Number of Recipients (c)	Dollar Amount (d)	Number of Recipients (e)	Dollar Amount (f)
1	Rooms	75,009	\$2,043		
2	Food	125,357	2,115		
3	Beverage	581,693	1,502		
4	Travel			412	173
5	Bus Program Cash	99,980	2,288		
6	Other Cash Complimentaries	61,838	4,369		
7	Entertainment				
8	Retail & Non-Cash Gifts			180,430	1,356
9	Parking			143,380	430
10	Other	306	3		
11	Total	944,183	\$12,320	324,222	\$1,959



# ACE GAMING, LLC T/A SANDS CASINO & HOTEL STATEMENT OF CONFORMITY, ACCURACY, AND COMPLIANCE

FOR THE QUARTER ENDED SEPTEMBER 30, 2006

1. I have examined this Quarterly Report
2. All the information contained in this Quarterly Report has been prepared in conformity with the Casino Control Commission's Quarterly Report Instructions and Uniform Chart of Accounts.
3. To the best of my knowledge and belief, the information contained in this report is accurate.
4. To the best of my knowledge and belief, except for the deficiencies noted below, the licensee submitting this Quarterly Report has remained in compliance with the financial stability regulations contained in N.J.A.C. 19:43-4.2(b)1-5 during the quarter.

November 14, 2006

Date



Keith Crede

Executive Director of Finance

Title

6939-11

License Number

On Behalf of:

ACE GAMING, LLC T/A SANDS CASINO & HOTEL  
Casino Licensee

**ACE GAMING, LLC**  
**NOTES TO FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**Note 1. The Company**

Atlantic Coast Entertainment Holdings, Inc., or Atlantic Holdings or the Company, owns and operates The Sands Hotel and Casino, or The Sands, located in Atlantic City, New Jersey through our wholly-owned subsidiary, ACE Gaming, LLC, or ACE Gaming, a New Jersey limited liability company. The Sands is located on approximately 6.1 acres of land one half block from the Boardwalk at Brighton Park, between Indiana Avenue and Dr. Martin Luther King, Jr. Boulevard.

Atlantic Holdings is an indirect majority-owned subsidiary of American Real Estate Partners, L.P., or AREP, a Delaware master limited partnership whose units are traded on the New York Stock Exchange. As of September 30, 2006, affiliates of Carl C. Icahn owned 9,813,346 Preferred Units and 55,655,382 Depositary Units, which represent approximately 86.5% of the outstanding Preferred Units and approximately 90.0% of the outstanding Depositary Units of AREP. Mr. Icahn is the Chairman of the Board of Directors and owns all of the capital stock of American Property Investors, Inc., AREP's general partner.

**Note 2. Sale of ACE Gaming**

On September 3, 2006, Atlantic Holdings, ACE Gaming, American Real Estate Holdings Limited Partnership, or AREH, a subsidiary of AREP, and certain other entities owned by or affiliated with AREH entered into an agreement, or the Agreement, with Pinnacle Entertainment, Inc., or Pinnacle, pursuant to which Pinnacle agreed to acquire all of the outstanding membership interests in ACE Gaming and equity interests in entities which are indirect subsidiaries of AREH which own parcels of real estate adjacent to The Sands, including real property known as the Traymore site, for approximately \$250 million (of which approximately \$189 million is payable to Atlantic Holdings and approximately \$61 million is payable to affiliates of AREH for the Traymore site); we will also receive an additional \$20 million from Pinnacle for certain tax-related benefits and additional real estate. In connection with Pinnacle's execution of the Agreement, it deposited \$50 million in escrow and such money is payable to Atlantic Holdings under certain situations if Pinnacle does not consummate the transaction.

As part of the Agreement, Pinnacle required that Atlantic Holdings close the existing hotel-casino, which took place on November 11, 2006.

The transaction is subject to the satisfaction of customary closing conditions. The transaction is not subject to financing. The majority stockholder of Atlantic Holdings, AREP Sands Holding, LLC, or AREP Sands, which owns approximately 58.2% of the outstanding stock of the Company, has delivered a stockholder written consent approving the transaction. AREP Sands is a wholly-owned subsidiary of AREH.

On September 3, 2006, simultaneous with the execution of the Agreement, Atlantic Holdings and AREH entered into an Indemnification Agreement, or the Indemnification Agreement, pursuant to which Atlantic Holdings agreed to indemnify AREH and its affiliates for Atlantic Holdings', as well as certain of AREH's, indemnification obligations under the Agreement. Under the terms of the Indemnification Agreement, Atlantic Holdings agreed to escrow the net proceeds from the sale of ACE Gaming.

Both the indenture governing our 3% Notes due 2008 and our existing line of credit have been terminated; accordingly the liens securing each obligation have also been terminated and released.

As of September 30, 2006, the Company had accrued \$7.9 million for one-time benefits, in connection with the impending sale, which is included in other accrued expenses on the accompanying condensed balance sheet. As of September 30, 2006, no such benefits had been paid.

### **Note 3. Basis of Presentation**

The financial statements have been prepared following the requirements of the Casino Control Commission of the State of New Jersey for interim reporting. Accordingly, certain footnotes or other financial information that are normally required by GAAP ( U.S. generally accepted accounting principles) can be condensed or omitted.

In the opinion of management, the accompanying financial statements include all adjustments (consisting only of those of a normal recurring nature), which are necessary for a fair presentation of the results for the interim periods presented. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to such rules and regulations of the SEC. Interim results are not necessarily indicative of results to be expected for any future interim period or for the entire fiscal year.

#### **Recently Issued Accounting Pronouncements**

In June 2006, the FASB issued Interpretation No. 48, or FIN No. 48, "Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109." This interpretation clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN No. 48 prescribes a recognition threshold and measurement principles for financial statement disclosure of tax positions taken or expected to be taken on a tax return. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company believes that the adoption of FIN No. 48 will not have a material impact on its financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin, or SAB No. 108, which provides guidance on the process of quantifying financial statement misstatements. In SAB No. 108, the SEC staff establishes an approach that requires quantification of financial statement errors, under both the iron-curtain and the roll-over methods, based on the effects of the error on each of our financial statements and the related financial statement disclosures. SAB No. 108 is generally effective for annual financial statements in the first fiscal year ending after November 15, 2006. The transition provisions of SAB No. 108 permits existing public companies to record the cumulative effect in the first year ending after November 15, 2006 by recording correcting adjustments to the carrying values of assets and liabilities as of the beginning of that year with the offsetting adjustment recorded to the opening balance of retained earnings. The Company believes that the adoption of SAB No. 108 will not have a material impact on its financial statements.

In September 2006, the FASB issued SFAS No. 157 "Fair Value Measurements". SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements, where fair value is the relevant measurement attribute. The standard does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company believes that the adoption of SFAS 157 will not have a material impact on its financial statements.

### **Note 4. Related Party Transactions**

On September 3, 2006, simultaneous with the execution of the Agreement, Atlantic Holdings and AREH entered into the Indemnification Agreement, pursuant to which [Atlantic Holdings](#) agreed to indemnify AREH and its affiliates for Atlantic Holdings', as well as certain of AREH's, indemnification obligations under the Agreement. Under the terms of the Indemnification Agreement, Atlantic Holdings agreed to escrow the net proceeds from the sale of ACE Gaming.

The Company has an intercompany services arrangement with American Casino & Entertainment Properties LLC, or ACEP, which is controlled by AREP, under which ACEP provides management and consulting services. The Company is billed based upon an allocation of salaries plus an overhead charge of 15% of the salary allocation plus reimbursement of reasonable out-of-pocket expenses. For the three months ended September 30, 2006 and 2005, we were billed approximately \$107,000 and \$189,000, respectively by ACEP.

For the nine months ended September 30, 2006 and 2005 the Company was billed approximately \$310,000 and \$504,000, respectively by ACEP.

During the three and nine months ended September 30, 2006 and 2005 the Company made payments to XO Communications, Inc., which is controlled by affiliates of Mr. Icahn, for certain telecommunications services provided to us. The payments totaled approximately \$31,000 and \$34,000 for the three months ended September 30, 2006 and 2005, respectively, and \$138,000 and \$119,000 for the nine months ended September 30, 2006 and 2005, respectively.

On June 5, 2006, ACE Gaming entered into a call agreement, the Option Agreement, with American Real Estate Holdings Limited Partnership, or AREH, pursuant to which AREH granted ACE Gaming the option to acquire all of its membership interests in AREP Boardwalk Properties, LLC, or AREP Boardwalk. AREP Boardwalk purchased 7.7 acres of land adjacent to the Sands property, or the Traymore Site, on May 19, 2006 and has an arrangement with ACE Gaming to manage the surface parking lots on its behalf. The Option Agreement allows ACE Gaming to exercise its option at any time until 5:00 PM on June 5, 2007. The Option Agreement provides that the purchase price of the membership interests underlying the option set forth therein is the sum of \$61 million (the price paid by AREP Boardwalk to acquire the Traymore Site), the Traymore Closing Costs (as defined in the Option Agreement), the Traymore Financing Costs (as defined in the Option Agreement); and the Operating Costs (as defined in the Option Agreement), plus, in each case, interest thereon at a rate of 8% per annum less any revenue received by AREP Boardwalk or AREH from the Traymore Site. As part of the sale agreement with Pinnacle, this call agreement will be transferred to Pinnacle [upon the consummation of the sale of ACE Gaming](#).

As of September 30, 2006 and 2005, the Company owed approximately \$188,000 and \$1,014,000, respectively, to related parties. This relates to the intercompany services arrangement with ACEP and AREP Boardwalk.

In connection with the consent solicitation and the offer to exchange, which was consummated on July 22, 2004, or the Transaction, GB Holdings, Inc., Greate Bay Hotel and Casino, Inc., or GBHC, Atlantic Holdings and ACE Gaming entered into a Contribution Agreement, pursuant to which, Atlantic Holdings paid approximately \$0.0 and \$2.6 million to GB Holdings for the three and nine months ended September 30, 2005, respectively. No amounts were paid to GB Holdings, Inc. in connection with the Contribution Agreement during 2006. In 2005 ACE Gaming paid GB Holdings approximately \$2.4 million for interest payments on the GB Holdings 11% notes due 2005 which were not previously exchanged for our 3% notes in the Transaction. Additionally, ACE Gaming agreed to pay GB Holdings an amount equal to GB Holdings' normal, ordinary course operating expenses (including legal and accounting costs, directors' and officers' insurance premiums, and fees for SEC filings) not to exceed in the aggregate \$250,000 in any twelve month period, subject to a number of conditions.

During May 2005, affiliates of Mr. Icahn converted approximately \$28.8 million principal amount of the Company's 3% notes into 1,898,181 shares of Atlantic Holdings common stock, and following the conversion of the notes, affiliates of Mr. Icahn exercised 7,748,412 warrants for an aggregate of 2,130,904 shares of Atlantic Holdings common stock. During 2005, other warrant holders exercised 17,789 warrants for 4,892 shares of Atlantic Holdings common stock. On September 7, 2006, affiliates of Mr. Icahn, as the majority holder of the 3% notes, elected to cause the conversion of the \$37.5 million in outstanding principal amount of the 3% notes into shares of Atlantic Holdings common stock. Prior to such conversion, the affiliates held \$35.1 million of the 3% notes and, as a result of the conversion, such affiliates received 2,314,990 shares of Atlantic Holdings common stock. The other 3% notes are held by third parties, are no longer outstanding and the holders thereof received an aggregate of 153,894 shares of our common stock.

#### **Note 5. Line of Credit**

As of September 30, 2006 and 2005, the Company had outstanding borrowings of \$0 and \$1.0 million, respectively. The outstanding principal balance accrued interest at a rate which was fixed monthly and equal to one month LIBOR (but not less than 1.5%), plus 8% per annum, which totaled 13.3% at September 30, 2006. The line of credit was cancelled on September 20, 2006 in accordance with the terms of the Agreement. Upon

Atlantic Holdings' termination of its line of credit, Atlantic Holdings paid a \$50,000 prepayment fee in accordance with the terms of the credit facility.

## **Note 6. Commitments and Contingencies**

### ***Legal Proceedings***

On October 13, 2006, the Official Committee of Unsecured Creditors, or the Committee, of GB Holdings, Inc., or GBH, was granted standing by the Bankruptcy Court to commence litigation in the name of GBH against the Company, ACE Gaming, AREP and other entities affiliated with Mr. Icahn as well as the directors of GBH. The Committee has indicated that it will challenge the July 2004 transaction that, among other things, resulted in the transfer of The Sands to ACE Gaming, the exchange of certain of GBH's notes for the 3% notes, and AREP owning approximately 58.2% of the outstanding shares of Atlantic Holdings common stock.

The Company challenged our property tax assessment in the Tax Court of New Jersey beginning with the tax year 1996 and including each year thereafter through 2006. A trial was held with respect to tax years 1996 through 1999. On May 12, 2006 an opinion was issued by the tax court upholding the original assessment for 1996 and reducing the tax assessment for the remaining three years. The Company is currently determining whether to appeal this decision. This decision, if upheld, would result in a refund of \$3,290,539 plus interest. A trial for tax years 2000 through 2006 is anticipated to be scheduled in the near future. Under the terms of the Agreement, Pinnacle will receive the first \$10 million of any refund and any additional amounts would be split between Pinnacle and Atlantic Holdings. As with any litigation there can be no assurance of the ultimate outcome, our ability to collect any judgment which may be awarded, or the terms under which any amount awarded or mutually agreed upon would be paid.

The Company is, from time to time, parties to various legal proceedings arising out of our businesses. The Company believes, however, there are no proceedings pending or threatened against the Company, which, if determined adversely, would have a material adverse effect upon our business financial conditions, results of operations or liquidity.

## **Note 7. Income Taxes**

The income tax expense recorded is attributable to two current New Jersey minimum income tax statutes. The New Jersey Business Tax Reform Act enacted in 2002 introduced a new alternative minimum assessment under the New Jersey corporate income tax provisions based on gross receipts or gross profits. Any minimum taxes paid under this statute are available as a credit against future New Jersey corporate income taxes. Additionally, in 2003, the New Jersey Casino Control Act imposed a new "Casino Net Income Tax" which assesses an annual tax equal to the greater of 7.5% of adjusted net income or \$350,000. Both of these enacted tax provisions expire in 2006.

Additionally, the company accounts for income tax assets and liabilities in accordance with SFAS No. 109 which requires a "more likely than not" criterion be applied when evaluating the realizability of a deferred tax asset. In assessing the realizability of deferred tax assets, management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies. Management believed that it was more likely than not that the tax benefits of certain future deductible temporary differences would be realized based on the reversal of existing temporary differences, and therefore, a valuation allowance was not provided for these deferred tax assets. Further, management had determined that the realization of certain of the Company's deferred tax assets was not more likely than not and, as such, provided a valuation allowance against those deferred tax assets.

**NOTE 8. PREPAID EXPENSES AND OTHER CURRENT ASSETS**

Prepaid expenses and other current assets consisted of the following:

	<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(in thousands)</b>	
Deposits - Workers Compensation	\$ 2,553	\$ 3,319
Prepaid slot license fee	750	810
Prepaid insurance	515	407
Prepaid real estate tax	-	835
Other current assets	970	778
	<u>\$ 4,788</u>	<u>\$ 6,149</u>

**NOTE 9. INVESTMENTS, ADVANCES AND RECEIVABLES**

Investments, advances and receivables consisted of the following Casino Reinvestment and Development Authority ("CRDA") investments:

	<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(in thousands)</b>	
CRDA deposits	\$ 18,242	\$ 17,528
CRDA bond receivables	8,005	8,176
	26,247	25,704
Less valuation allowance on CRDA investments	(12,717)	(13,008)
	<u>\$ 13,530</u>	<u>\$ 12,696</u>

**NOTE 10. PROPERTY AND EQUIPMENT**

Property and equipment consisted of the following:

	<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(in thousands)</b>	
Land	\$ 54,272	\$ 54,344
Buildings and improvements	88,133	88,186
Operating equipment	83,129	77,923
Construction in progress	819	782
	226,353	221,235
Less: accumulated depreciation and amortization	(71,987)	(58,132)
Net property and equipment	<u>\$ 154,366</u>	<u>\$ 163,103</u>

**NOTE 11. OTHER ACCRUED EXPENSES**

Other accrued expenses consisted of the following:

	<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(in thousands)</b>	
Accrued - severance	\$ 7,960	\$ -
Accrued - bonus	2,215	-
Accrued vacation	1,607	1,578
Major Medical - Non-union	1,091	1,230
Other accrued expenses	7,901	8,305
	<u>\$ 20,774</u>	<u>\$ 11,113</u>

**NOTE 12. OTHER CURRENT LIABILITIES**

Other current liabilities consisted of the following:

	<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(in thousands)</b>	
Workers Comp liability	\$ 1,395	\$ 1,255
CRDA bonds payable	547	601
Unredeemed gaming chips	508	490
Union liability	400	535
Other current liabilities	1,134	1,206
	<u>\$ 3,984</u>	<u>\$ 4,087</u>

**NOTE 13. OTHER LIABILITIES**

Other liabilities consisted of the following:

	<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(in thousands)</b>	
CRDA - East Hall	\$ 3,710	\$ 3,548
Other liabilities	724	722
	<u>\$ 4,434</u>	<u>\$ 4,270</u>

**NOTE 14 NONOPERATING INCOME (EXPENSE) – NET**

Nonoperating income (expense) – net is comprised of the following:

	<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(in thousands)</b>	
CRDA Interest Income	\$ 566	\$ 352
Interest income	210	68
Re-organization expenses	-	(20)
	<u>\$ 776</u>	<u>\$ 400</u>